

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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OFFICE OF THE SECRETARY

In the Matter of)	
)	
1998 Biennial Regulatory Review)	CC Docket No. 98-137
Review of Depreciation Requirements)	
Incumbent Local Exchange Carriers)	
)	
United States Telephone Association)	ASD 98-91
Petition for Forbearance From)	
Depreciation Regulation of Price Cap)	
Local Exchange Carriers)	
)	

MCI WORLDCOM REPLY COMMENTS

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MCI WORLDCOM REPLY COMMENTS

I. Introduction and Summary

MCI WorldCom hereby submits its Reply to Comments filed on USTA's Petition for Forbearance from Depreciation Regulation and on the Notice of Proposed Rulemaking (NPRM) in the CC Docket No. 98-137 depreciation biennial review proceeding.

Contrary to the ILECs' claims, the elimination of sharing from the Commission's price cap regime has not eliminated the need for Commission prescription of depreciation rates. The Commission's regulatory mechanisms for ensuring that ILEC rates are just and reasonable still rely to a substantial extent on the ILECs' accounting costs, which include depreciation expense. Because depreciation expense represents a significant portion of the

ILECs' costs, overstated depreciation expense would distort the Commission's monitoring of the price cap regime, would increase the probability of erroneous triggering of the low-end adjustment mechanism, and would distort exogenous cost calculations.

As long as competition is insufficient to constrain the ILECs' rates, and as long as the Commission's regulatory mechanisms continue to rely on accounting costs, the Commission must continue to prescribe depreciation rates. Contrary to the ILECs' contentions, Generally Accepted Accounting Principles (GAAP) alone would not be sufficient to protect the ILECs' customers. As the Commission has noted previously, while the "conservatism" principle that underlies GAAP is effective in protecting the interests of investors, it may not always serve the interests of ratepayers.

Consequently, the Commission should reject the ILECs' proposal that they be permitted to rely on GAAP. The Commission should also reject the ILECs' alternative proposal that the Commission prescribe shorter depreciation lives. The depreciation lives prescribed by the Commission are appropriately forward-looking.

II. Depreciation Regulation is Still Necessary

Even the ILECs recognize that the link between rates and accounting costs has not been eliminated by the adoption of a no-sharing price cap regime. In fact, the ILECs specifically insist on their right to claim a low-end adjustment or to file for above-cap rate increases.¹

¹ See Bell Atlantic Comments at n. 4, BellSouth Comments at n. 15,

While the ILECs recognize that the link between rates and accounting costs, including depreciation expense, continues to exist, the ILECs contend that reliance on GAAP principles alone would be sufficient.² They argue further that the Commission could assess the reasonableness of depreciation expense on a case-by-case basis, as exogenous cost changes are made or if an ILEC claims a low-end adjustment or above-cap rate increase.³

However, as MCI WorldCom explained in its Comments, the conservatism principle that governs GAAP is intended to protect the interests of investors, not ratepayers.⁴ As the Commission has stated:

Although conservatism is effective in protecting the interest of investors, it may not always serve the interest of ratepayers. Conservatism could be used under GAAP, for example, to justify additional (but, perhaps not "reasonable") depreciation expense by a LEC....⁵

The ILECs' proposal that the Commission review depreciation rates and depreciation expense on an as-needed basis is completely impractical. In effect, the Commission would be required to conduct a depreciation represcription each time an

² See, e.g., Ameritech Comments at 2.

³ See, e.g., Bell Atlantic Comments at 6-7, SBC Comments at 7, BellSouth Comments at 15-17.

⁴ MCI WorldCom Comments at 8-9.

⁵ Prescription Simplification, Report and Order, FCC 93-452, released October 20, 1993, para. 46.

ILEC claimed a low-end adjustment, filed above-cap rates, or filed an exogenous cost change. Obviously, the 15 days' notice on which ILEC tariffs are filed is insufficient for the Commission to determine the depreciation rates that would be reasonable. Moreover, the cumulative burden of these ad hoc represcriptions would be significantly greater than the current, well-established, process under which the Commission prescribes depreciation rates on an ongoing basis.

Even the ILECs appear to recognize that it would be impossible for the Commission to determine the depreciation rates that are appropriate for regulatory purposes in the short time available for tariff review. Their answer is that the Commission could rely on "benchmarks"⁶ or could "establish a rebuttable presumption that the depreciation rates . . . used for financial reporting purposes are correct."⁷ In effect, then, the ILECs are asking the Commission to accept GAAP lives as reasonable. As discussed above, however, GAAP lives are not necessarily appropriate for ratemaking purposes.

Furthermore, even if some type of case-by-case review of the depreciation expense claimed as part of an exogenous cost change, low-end adjustment, or above-cap filing were feasible -- which it is not -- this approach would not take into account the variety of other essential roles played by Commission-prescribed depreciation rates. As several commenters point out, there is an extensive list of reasons why the Commission must continue to prescribe depreciation rates.⁸ Most importantly, the Commission must

⁶ BellSouth Comments at 15-16.

⁷ Bell Atlantic Comments at 6.

⁸ Ad Hoc Comments at 5-7; AT&T Comments at 16-20.

continue to prescribe depreciation rates in order to ensure consistent reporting of ILEC rates of return, which are used by the Commission to assess the performance of its price cap regime.

III. The Depreciation Lives Prescribed By The Commission are Appropriate

It is apparent that the ILECs' objective in this proceeding is to obtain authority to use shorter depreciation lives. Most ILECs propose that, if the Commission does not forbear from prescribing depreciation lives, the Commission prescribe much shorter depreciation lives.⁹

The Commission should reject this proposal. The depreciation lives prescribed by the Commission are appropriately forward-looking; the shorter depreciation lives that the ILECs propose would harm ratepayers by distorting the Commission's evaluation of the price cap regime's performance and by increasing the probability of unwarranted low-end adjustments.

A. The Depreciation Lives Prescribed By The Commission Are Forward-Looking

Some ILECs contend that the projection lives prescribed by the Commission are not forward-looking.¹⁰ Other ILECs complain that the Commission's life prescriptions

⁹ See, e.g., BellSouth Comments at 12.

¹⁰ See, e.g., Comments of Ameritech at 5-6; Bell Atlantic at 9-10; SBC at 16-23.

are out-of-date and far too long.¹¹ In fact, it is the ILEC criticisms that are out-of-date, not the Commission's life prescriptions.

In 1980 the Commission recognized that "[t]he seeming attraction of stretching out lives to hold down depreciation expense may impose longer-term costs on our society that far outweigh short-term advantages."¹² The Commission determined that many of the life estimates being used to establish depreciation rates were unrealistically long, and directed its staff to develop new procedures to reduce the possibility that such large errors in forecasts would occur again.¹³ The Commission staff responded by placing less emphasis on historic data and paying closer attention to company plans, technological developments, and other future-oriented analyses.¹⁴

The effect of this change to a forward-looking orientation has been dramatic and can be seen by tracing depreciation reserve levels. As the Commission has recognized, "[t]he depreciation reserve is an extremely important indicator of the depreciation process because it is the accumulation of all past depreciation accruals net of plant retirements. As

¹¹ See, e.g., Comments of BellSouth at 6-7, 12; U S West at 10-13; GTE at 12-15.

¹² Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies), Docket No. 20188, Report and Order, FCC 80-650, released December 5, 1980, ¶ 49.

¹³ Report on Telephone Industry Depreciation, Tax and Capital/Expense Policy, Accounting and Audits Division, Federal Communications Commission, April 15, 1987 ("AAD Report") at 8.

¹⁴ Id.

such, it represents the amount of a carrier's original investment that has already been returned to the carrier by its customers.”¹⁵

Attachment 1 to these Reply Comments displays reserve levels and other plant rates since 1946 for all ILECs providing full financial reports to the Commission. As shown on Page 1 of Attachment 1, the reserve percent decreased steadily following World War II due to industry growth. These declines continued through the 1970s due in part to accrual rates that were too low.¹⁶ As shown on Page 1 of Attachment 1, however, the Commission's change to forward-looking depreciation practices in the early 1980s resulted in a dramatic rise in reserve levels after 1980. The composite reserve level rose from 18.7 percent in 1980 to a historic high of 48.8 percent in 1997. This track record indicates that the current depreciation process is resulting in adequate depreciation accruals, and that the Commission's life estimates have been forward-looking and unbiased.

Confirmation of the forward-looking nature of current Commission prescriptions can be gained by comparing the 1997 accrual rate of 7.1 percent (Attachment 1, Page 4, Column l) to the 1997 retirement rate of 4.0 percent (Attachment 1, Page 4, Column k). The prescription of an accrual rate much higher than the current retirement rate indicates an expectation that the retirement rate will be much higher in the future. If the Commission were prescribing depreciation rates based upon historical indicators, it would be prescribing depreciation rates in the range of 3 to 5 percent.

¹⁵ Id. at 5-6.

¹⁶ AAD Report at 7.

B. The Lives Recommended By TFI Are Too Short For Regulatory Use

Several ILECs propose the adoption of projection lives based upon the recommendations of Technology Futures, Inc. ("TFI").¹⁷ TFI's recommendations are based upon studies sponsored by the Telecommunications Technology Forecasting Group ("TTFG"), an industry association of major ILECs in the United States and Canada.¹⁸ TFI's studies have been frequently used by ILECs to justify shorter lives in regulatory depreciation proceedings.

TFI develops its estimates through "substitution analysis," which attempts to forecast the pattern by which new technology will replace old technology.¹⁹ The assumption that the future will be much like the past is the very basis of substitution analysis. TFI predicts an "avalanche" of retirements in various accounts based upon the application of past retirement patterns of obsolete technologies to future circumstances. This technique relies, for example, on retirement patterns such as those describing the replacement of crossbar switches in the 1980's.²⁰ In their own way, substitution analyses are as dependent on historical data as mortality analyses.

TFI's recommendation lives are based upon the premise that the LECs will replace their narrowband telecommunications networks with broadband integrated networks

¹⁷ Comments of Ameritech at 10; SBC at 21; Sprint at 6; CBT at 7-8.

¹⁸ Transforming the Local Exchange Network: Analyses and Forecasts of Technology Change, by Lawrence K. Vanston, Ray L. Hodges and Adrian J. Poitras (2d ed. 1997), at vii - viii.

¹⁹ Id., at 4-7.

²⁰ Id., at 29.

capable of providing both telecommunications services and video services, such as cable television.²¹ According to TFI, Fiber In The Loop ("FITL") will bring broadband to the home, displacing copper plant.²² This will result in the upgrading of all transmission systems to Synchronous Optical Network ("SONET"), replacing existing circuit equipment.²³ And Asynchronous Transfer Mode ("ATM") switching equipment will provide a broadband switching capability replacing today's narrowband switch fabrics.²⁴

The output of a substitution analysis is only as correct as the inputs selected, however. Substitution analysis merely provides a convenient method for plotting by year the growth of a new technology assuming the inputs to the formula are correct.

Substitution analysis is not even relevant unless it is known that a new technology will replace, not supplement, an older technology. For example, ATM switches will be deployed as a supplemental technology to digital switches, not as a replacement for them. As such, substitution analysis is of no relevance.

Indeed, even when a substitution has started, it does not necessarily follow that it will finish according to pattern. It appeared at one point, for example, that nuclear fuel would replace fossil fuel in electrical generation in this country. The use of substitution formulae in that case would have resulted in dramatically incorrect predictions.

²¹ Id., at 2, 27 and passim.

²² Id., at 2, 8-16 and 74-111.

²³ Id., at 2, 16-19 and 113-125.

²⁴ Id., at 2, 23-27 and 159-172.

Even if a full substitution is likely, the formula requires the user to predict both the rate of substitution and the point at which the replacement technology will reach 50 percent of the universe.²⁵ In other words, the analyst must insert as an input, the average remaining life of the old technology, since this is essentially the 50 percent level of the new technology. Although the substitution methodology allows the preparation and presentation of impressive looking charts and tables, it is merely charting the assumptions made by the analyst. Its outputs at the hands of TFI are no more credible than TFI's inputs.

Although TFI's forecasts have been provided to the Commission for nearly a decade, they have not been relied upon in the selection of plant projection lives. The forward-looking lives prescribed by the Commission already reflect the life shortening effects of technological change and potential competition. Moreover, the resale and unbundled network element provisions of the Telecommunications Act of 1996 may increase demand for existing facilities and thus lengthen plant lives.

Competition may act in other ways to lengthen plant lives. It is generally accepted that competition spurs innovation and drives prices toward cost. While some innovations result in the replacement of existing plant, others result in the enhancement of existing plant. For example, the ILECs appear to have set aside their plans to replace their copper distribution plant with fiber and coax and chosen instead to implement Digital Subscriber

²⁵ The formula can also be used by selecting the rate of substitution and the 1 percent level.

Line (“DSL”) technology -- an enhancement to existing plant. In this case, innovation has served not to shorten the life of existing plant, but to extend it.²⁶

In summary, the dramatic “avalanche” of retirements predicted by TFI is not about to happen, and TFI’s life recommendations are far too short for regulatory use.

C. The Life Comparisons Made By SBC Are Irrelevant

SBC attempts to support its very short life proposals by comparing them to the lives prescribed by the Commission for AT&T in 1994 and the lives used by the ILECs and other companies in preparing their financial books.²⁷ None of these comparisons are relevant.

1. AT&T Prescribed Lives are Irrelevant

Any comparison to lives prescribed for AT&T in 1994 is irrelevant because AT&T was an interexchange carrier (“IXC”). The same order that prescribed the lives for AT&T in 1994 also prescribed much longer lives for thirteen ILECs. Clearly, the Commission recognized the difference between the appropriate lives for an IXC and an ILEC. The FCC explicitly noted the difference in its Prescription Simplification proceeding when it stated:

We believe the underlying considerations that go into estimating the basic factors are sufficiently different for the two groups [IXC

²⁶ Dr. Harris notes that the ILECs hope that DSL technologies “will extend the economic lives of a large portion of their existing plant by providing high speed connections to the Internet.” Comments of SBC, Exhibit A, at 11.

²⁷ Comments of SBC at 21-22.

and ILEC] that they should be considered separately.²⁸

The plant lives of IXCs are simply not appropriate for use in ILEC depreciation proceedings. The expected productive life of plant is largely dependent upon its specific use. Despite surface similarity, the use of plant by ILECs to provide local exchange and exchange access service is much different than the use of plant by IXCs to provide interexchange services. First, the key investments in ILEC depreciation proceedings are local loops and end office switches. AT&T had neither local loops nor end office switches in 1994, and the lives prescribed for it are thus totally irrelevant to the determination of ILEC lives.

Second, IXCs are much less capital intensive than ILECs, and thus are able to economically replace their plant much faster than ILECs when the occasion demands. To service all homes and business in the Nation, an IXC needs only about 150 switches and 100,000 sheath kilometers of cable.²⁹ To gain the same ubiquity for local exchange service, the ILECs require over 23,000 switches and 6,000,000 sheath kilometers of cable.³⁰ No matter how motivated the ILECs may be, the sheer magnitude and complexity of the replacement effort ensures that replacement is long, drawn-out process.

²⁸ Simplification of the Depreciation Prescription Process, CC Docket No. 92-296 ("Prescription Simplification"), Notice of Proposed Rulemaking, FCC 92-296, released December 29, 1992.

²⁹ 1994 FCC Statistics of Common Carriers at 159.

³⁰ Id.

2. Financial Book Lives are Irrelevant

Because the depreciation lives used for regulatory purposes should balance the interests of investors and ratepayers, the depreciation lives used for financial book purposes are totally irrelevant. As discussed above, financial book lives conform to GAAP's conservatism principle and are intended to protect the interests of investors. They do not provide an acceptable substitute for Commission prescriptions as recommended by a number of ILECs.³¹

IV. The Large ILECs Do Not Have A Depreciation Reserve Deficiency

SBC and GTE claim in their Comments that they have multi-billion depreciation reserve deficiencies.³² Ameritech claims that the ILECs have a combined reserve deficiency of \$34 billion.³³

There is no merit to these claims. The calculations underlying them are based upon the lives used by the ILECs in preparing their financial reports. As discussed above, the conservative bias of these lives, intended to protect investors, has no relevance to regulatory deliberations.

Attachment 2 to these Reply Comments compares the book reserves of the large ILECs to their theoretical reserves based upon Commission prescribed lives as of January 1, 1998. In total, Attachment 2 shows a surplus of \$4.5 billion, not a deficiency. If

³¹ See, e.g., Comments of BellSouth at 4-5. Bell Atlantic at 5-6; GTE at 12-15.

³² Comments of SBC at 25; GTE at 5.

³³ Comments of Ameritech at 6.

anything, this would indicate that ILEC plant has been overdepreciated, not underdepreciated.

If ILEC plant was underdepreciated, one would expect this condition to be reflected in the market price of ILEC stocks. In fact, quite the opposite is true. Attachment 3 to these Reply Comments shows that the market-to-book ratios of the large ILECs range from 4.5 to 7.5, even after adding back the effect on equity of the financial book plant writedowns taken by each carrier. Clearly, the investment community does not appear to be concerned about reserve deficiencies.

Further evidence that the ILECs do not have depreciation reserve problems can be gained by examining recent or planned purchases of one ILEC by another. Attachment 4 to these Reply Comments compares that price paid for five ILEC to the financial book value of each, again adding back the effect of plant writedowns. The huge premiums being paid for these ILECs belie the existence of depreciation reserve deficiencies. Again, the objective observer might conclude that ILEC plant has been overdepreciated, not underdepreciated.

V. Conclusion

For the reasons stated herein, the Commission should deny USTA's petition for forbearance and should continue to prescribe ILEC depreciation rates.

Respectfully submitted,
MCI WORLDCOM, INC.

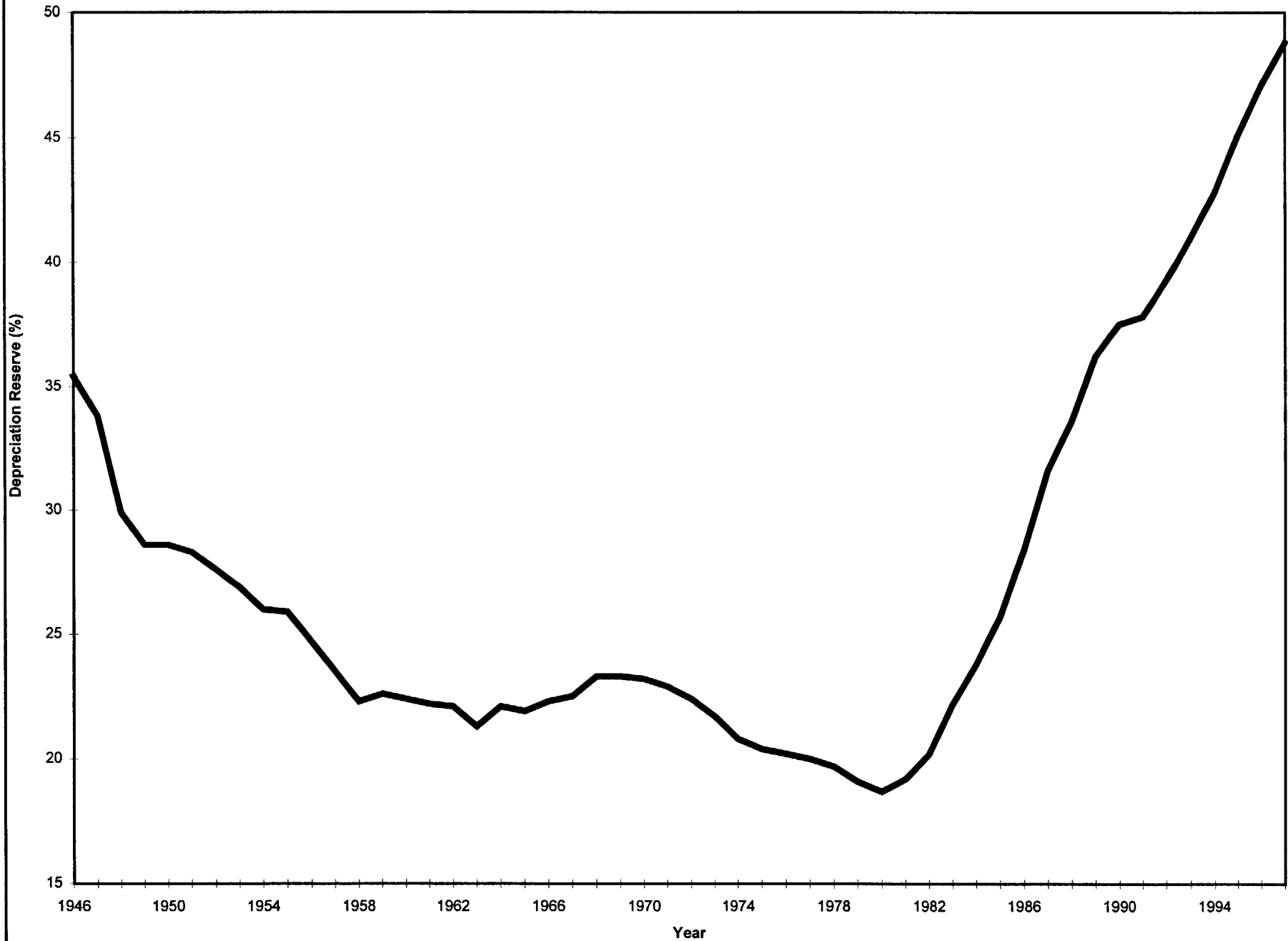
A handwritten signature in black ink, appearing to read "Alan Buzacott".

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Attachment 1

Depreciation Reserve Percent
All LECS



All LECs Plant Related Rates

(Dollars in Millions)

Telecommunications Plant in Service				Add (e)	Ret (f)	Deprec (g)	EOY Reserve (h)	AVG Reserve (i)	Add Rate (j) = e/a	Retire Rate (k) = f/a	Deprec Rate (l) = g/c	Reserve Percent (m) = h/b
BOY (a)	EOY (b)	Average (c)=(a+b)/2	Increase (d) = b-a									
1946		6,500	3,250				2,300					35.4
1947	6,500	7,400	6,950				2,500	2,400				33.8
1948	7,400	8,700	8,050				2,600	2,550				29.9
1949	8,700	9,800	9,250				2,800	2,700				28.6
1950	9,800	10,500	10,150				3,000	2,900				28.6
1951	10,500	11,300	10,900				3,200	3,100				28.3
1952	11,300	12,300	11,800				3,400	3,300				27.6
1953	12,300	13,400	12,850				3,600	3,500				26.9
1954	13,400	14,600	14,000				3,800	3,700				26.0
1955	14,600	15,800	15,200				4,100	3,950				25.9
1956	15,800	17,400	16,600				4,300	4,200				24.7
1957	17,400	19,600	18,500				4,600	4,450				23.5
1958	19,600	22,000	20,800				4,900	4,750				22.3
1959	22,000	23,000	22,500				5,200	5,050				22.6
1960	23,000	25,000	24,000	2,700	700	1,100	5,600	5,400	11.7	3.0	4.6	22.4
1961	25,000	27,000	26,000	2,800	800	1,200	6,000	5,800	11.2	3.2	4.6	22.2
1962	27,000	29,000	28,000	2,900	900	1,300	6,400	6,200	10.7	3.3	4.6	22.1
1963	29,000	32,000	30,500	4,000	1,000	1,400	6,800	6,600	13.8	3.4	4.6	21.3
1964	32,000	34,000	33,000	2,900	900	1,600	7,500	7,150	9.1	2.8	4.8	22.1
1965	34,000	37,000	35,500	4,100	1,100	1,700	8,100	7,800	12.1	3.2	4.8	21.9
1966	37,000	40,000	38,500	4,100	1,100	1,900	8,900	8,500	11.1	3.0	4.9	22.3
1967	40,000	44,000	42,000	5,100	1,100	2,100	9,900	9,400	12.8	2.8	5.0	22.5

All LECs Plant Related Rates
(Dollars in Millions)

	Telecommunications Plant in Service				Add (e)	Ret (f)	Deprec (g)	EOY Reserve (h)	AVG Reserve (i)	Add Rate (j) = e/a	Retire Rate (k) = f/a	Deprec Rate (l) = g/c	Reserve Percent (m) = h/b
	BOY (a)	EOY (b)	Average (c)=(a+b)/2	Increase (d) = b-a									
1968	43,249	47,123	45,186	3,874	5,104	1,230	2,304	10,979	10,440	11.8	2.8	5.1	23.3
1969	47,175	51,724	49,450	4,549	6,022	1,473	2,507	12,072	11,526	12.8	3.1	5.1	23.3
1970	51,723	56,951	54,337	5,228	6,880	1,651	2,751	13,213	12,643	13.3	3.2	5.1	23.2
1971	56,972	63,090	60,031	6,118	8,052	1,933	3,016	14,447	13,830	14.1	3.4	5.0	22.9
1972	63,068	69,870	66,469	6,802	9,044	2,242	3,330	15,643	15,045	14.3	3.6	5.0	22.4
1973	69,951	77,442	73,697	7,491	10,085	2,595	3,659	16,769	16,206	14.4	3.7	5.0	21.7
1974	77,107	84,888	80,998	7,781	11,024	3,243	4,047	17,685	17,227	14.3	4.2	5.0	20.8
1975	84,799	92,284	88,542	7,485	10,881	3,396	4,486	18,809	18,247	12.8	4.0	5.1	20.4
1976	92,591	99,879	96,235	7,288	11,139	3,856	4,934	20,163	19,486	12.0	4.2	5.1	20.2
1977	101,237	109,496	105,367	8,259	12,438	4,136	5,630	21,903	21,033	12.3	4.1	5.3	20.0
1978	109,502	119,336	114,419	9,834	14,549	4,681	6,199	23,474	22,689	13.3	4.3	5.4	19.7
1979	118,612	129,972	124,292	11,360	16,843	5,452	6,820	24,881	24,178	14.2	4.6	5.5	19.1
1980	129,767	142,096	135,932	12,329	18,694	6,378	7,804	26,512	25,697	14.4	4.9	5.7	18.7
1981	142,121	155,845	148,983	13,724	19,482	5,749	8,664	29,932	28,222	13.7	4.0	5.8	19.2
1982	155,907	168,075	161,991	12,168	18,466	6,409	9,757	33,957	31,945	11.8	4.1	6.0	20.2
1983	169,162	178,482	173,822	9,320	16,076	6,664	11,340	39,571	36,764	9.5	3.9	6.5	22.2
1984	152,315	159,798	156,057	7,483	14,994	4,994	10,048	37,996	38,784	9.8	3.3	6.4	23.8
1985	174,218	186,294	180,256	12,076	18,972	6,687	11,469	43,837	40,917	10.9	3.8	6.9	25.7
1986	186,972	198,758	192,865	11,786	18,907	6,954	13,142	51,543	47,690	10.1	3.7	7.5	28.4
1987	199,063	209,687	204,375	10,624	18,535	7,886	15,263	61,471	56,507	9.3	4.0	8.1	31.6
1988	210,720	220,395	215,558	9,675	17,947	8,949	16,627	74,123	67,797	8.5	4.2	7.7	33.6

All LECs Plant Related Rates

(Dollars in Millions)

	Telecommunications Plant in Service				Add (e)	Ret (f)	Deprec (g)	EOY Reserve (h)	AVG Reserve (i)	Add Rate (j) = e/a	Retire Rate (k) = f/a	Deprec Rate (l) = g/c	Reserve Percent (m) = h/b
	BOY (a)	EOY (b)	Average (c)=(a+b)/2	Increase (d) = b-a									
1989	220,126	229,326	224,726	9,200	16,868	8,145	16,839	83,115	78,619	7.7	3.7	7.5	36.2
1990	229,103	235,247	232,175	6,144	18,473	12,380	16,955	88,146	85,631	8.1	5.4	7.3	37.5
1991	236,093	241,620	238,857	5,527	18,322	12,896	16,607	91,427	89,787	7.8	5.5	7.0	37.8
1992	242,599	249,508	246,054	6,909	18,877	12,138	17,036	98,053	94,740	7.8	5.0	6.9	39.3
1993	250,570	258,782	254,676	8,212	18,864	11,217	17,676	106,079	102,066	7.5	4.5	6.9	41.0
1994	259,216	267,443	263,330	8,227	18,781	10,990	18,656	114,598	110,339	7.2	4.2	7.1	42.8
1995	268,555	278,946	273,751	10,391	19,482	9,411	19,393	125,789	120,194	7.3	3.5	7.1	45.1
1996	278,974	291,569	285,272	12,595	22,401	10,271	20,527	137,278	131,534	8.0	3.7	7.2	47.1
1997	291,569	303,809	297,689	12,240	23,171	11,627	21,156	148,163	142,721	7.9	4.0	7.1	48.8
Avg.	'60-'71									12.0	3.1	4.9	
	'72-'83									13.1	4.1	5.5	
	'84-'97									8.4	4.2	7.2	

Source: 1946 -1967 Report on Telephone Industry Depreciation, Tax and Capital/Expense Policy, Accounting and Audits Division, FCC, April 15, 1987, pp.6, 9
1968 - 1983 FCC Statistics of Common Carriers, Tables 12 and 16
1984 - 1987 FCC Statistics of Common Carriers, Tables 10 and 14
1988 - 1997 FCC Statistics of Common Carriers, Tables 2.7 and 2.9

Note 1: 1946 - 1983 Includes AT&T

Note 2: From FCC Statistics of Common Carriers, Table 14

Col l = 1985 Col g/165,076

1986 Col g/175,926

1987 Col g/187,920

Col m = 1985 Col h/170,355

1986 Col h/181,496

1987 Col h/194,343

Attachment 2

Summary of Reserves On FCC Basis

(Dollars in Thousands)

<u>Company</u>	<u>State</u>	<u>1/1/98 Investment</u> a	<u>Book Reserve</u> b	<u>Percent</u> c = b / a	<u>Theoretical Reserve</u> d	<u>Percent</u> e = d / a	<u>Surplus</u> f = b - d	<u>Percent</u> g = f / a
Ameritech	Illinois	9,337,835	4,547,920	48.7%	3,949,460	42.3%	598,461	6.4%
	Indiana	3,292,682	1,750,771	53.2%	1,584,651	48.1%	166,120	5.0%
	Michigan	8,291,247	4,422,741	53.3%	4,259,975	51.4%	162,766	2.0%
	Ohio	6,178,923	3,174,469	51.4%	2,872,997	46.5%	301,472	4.9%
	Wisconsin	<u>3,010,628</u>	<u>1,505,782</u>	<u>50.0%</u>	<u>1,446,305</u>	<u>48.0%</u>	<u>59,477</u>	<u>2.0%</u>
	Total	30,111,315	15,401,683	51.1%	14,113,387	46.9%	1,288,295	4.3%
Bell Atlantic	Delaware	791,614	352,284	44.5%	356,871	45.1%	-4,587	-0.6%
	Maine	1,383,669	742,889	53.7%	703,574	50.8%	39,315	2.8%
	Maryland	5,604,542	2,607,666	46.5%	2,637,993	47.1%	-30,327	-0.5%
	Massachusetts	8,143,394	4,044,639	49.7%	3,985,323	48.9%	59,316	0.7%
	New Hampshire	1,577,823	824,272	52.2%	788,631	50.0%	35,641	2.3%
	New Jersey	9,303,413	4,478,772	48.1%	4,457,669	47.9%	21,103	0.2%
	New York	20,063,205	10,058,278	50.1%	10,065,639	50.2%	-7,362	0.0%
	Pennsylvania	9,479,751	4,555,791	48.1%	4,706,318	49.6%	-150,527	-1.6%
	Rhode Island	947,985	497,597	52.5%	508,443	53.6%	-10,846	-1.1%
	Vermont	800,244	445,939	55.7%	429,561	53.7%	16,378	2.0%
	Virginia	5,729,042	2,637,840	46.0%	2,457,503	42.9%	180,337	3.1%
	Washington, DC	1,590,037	672,072	42.3%	712,286	44.8%	-40,214	-2.5%
	West Virginia	<u>1,691,722</u>	<u>902,536</u>	<u>53.4%</u>	<u>888,811</u>	<u>52.5%</u>	<u>13,724</u>	<u>0.8%</u>
	Total	67,106,440	32,820,575	48.9%	32,698,624	48.7%	121,951	0.2%
BellSouth	Alabama	4,495,450	2,305,080	51.3%	2,049,569	45.6%	255,511	5.7%
	Florida	11,221,015	5,913,028	52.7%	5,462,663	48.7%	450,364	4.0%
	Georgia	8,546,417	4,285,198	50.1%	3,951,720	46.2%	333,478	3.9%
	Kentucky	2,468,479	1,253,552	50.8%	1,116,112	45.2%	137,440	5.6%
	Louisiana	4,533,989	2,597,514	57.3%	2,307,926	50.9%	289,588	6.4%
	Mississippi	2,989,921	1,606,380	53.7%	1,437,854	48.1%	168,527	5.6%
	North Carolina	4,788,910	2,355,183	49.2%	2,230,763	46.6%	124,420	2.6%
	South Carolina	2,918,692	1,497,967	51.3%	1,442,795	49.4%	55,172	1.9%
	Tennessee	<u>4,908,301</u>	<u>2,333,198</u>	<u>47.5%</u>	<u>2,176,157</u>	<u>44.3%</u>	<u>157,041</u>	<u>3.2%</u>
	Total	46,871,174	24,147,099	51.5%	22,175,557	47.3%	1,971,542	4.2%

Summary of Reserves On FCC Basis

(Dollars in Thousands)

<u>Company</u>	<u>State</u>	<u>1/1/98 Investment a</u>	<u>Book Reserve b</u>	<u>Percent c = b / a</u>	<u>Theoretical Reserve d</u>	<u>Percent e = d / a</u>	<u>Surplus f = b - d</u>	<u>Percent g = f / a</u>
SBC	Arkansas	1,921,985	918,687	47.8%	984,063	51.2%	-65,376	-3.4%
	California	27,130,901	13,139,906	48.4%	12,663,353	46.7%	476,553	1.8%
	Kansas	2,393,837	1,097,939	45.9%	1,235,524	51.6%	-137,585	-5.7%
	Missouri	5,073,443	2,168,996	42.8%	2,478,115	48.8%	-309,119	-6.1%
	Nevada	560,175	264,127	47.2%	237,686	42.4%	26,440	4.7%
	Oklahoma	2,760,181	1,511,713	54.8%	1,538,676	55.7%	-26,963	-1.0%
	Texas	<u>18,013,871</u>	<u>8,661,272</u>	<u>48.1%</u>	<u>9,025,923</u>	<u>50.1%</u>	<u>-364,651</u>	<u>-2.0%</u>
	Total	57,854,392	27,762,639	48.0%	28,163,339	48.7%	-400,700	-0.7%
US West	Arizona	4,395,468	2,125,561	48.4%	2,110,689	48.0%	14,872	0.3%
	Colorado	5,788,312	2,525,422	43.6%	2,574,530	44.5%	-49,109	-0.8%
	Idaho	903,697	436,999	48.4%	432,647	47.9%	4,353	0.5%
	Iowa	1,849,387	1,035,760	56.0%	996,124	53.9%	39,636	2.1%
	Minnesota	3,734,262	1,908,132	51.1%	1,805,537	48.4%	102,595	2.7%
	Montana	746,906	339,195	45.4%	353,712	47.4%	-14,517	-1.9%
	Nebraska	1,359,563	718,547	52.9%	689,047	50.7%	29,500	2.2%
	New Mexico	1,698,443	821,014	48.3%	882,604	52.0%	-61,590	-3.6%
	North Dakota	483,840	277,106	57.3%	250,413	51.8%	26,692	5.5%
	Oregon	2,376,043	1,087,036	45.7%	1,132,790	47.7%	-45,754	-1.9%
	South Dakota	589,880	334,760	56.8%	304,391	51.6%	30,369	5.1%
	Utah	2,058,493	904,816	44.0%	957,748	46.5%	-52,932	-2.6%
	Washington	4,535,011	2,251,491	49.6%	2,296,235	50.6%	-44,744	-1.0%
	Wyoming	<u>711,946</u>	<u>351,080</u>	<u>49.3%</u>	<u>349,496</u>	<u>49.1%</u>	<u>1,584</u>	<u>0.2%</u>
	Total	31,231,251	15,116,919	48.4%	15,135,962	48.5%	-19,043	-0.1%
RBOCs	Total	233,174,572	115,248,914	49.4%	112,286,869	48.2%	2,962,045	1.3%

Summary of Reserves On FCC Basis

(Dollars in Thousands)

<u>Company</u>	<u>State</u>	<u>1/1/98 Investment</u> a	<u>Book Reserve</u> b	<u>Percent</u> c = b / a	<u>Theoretical Reserve</u> d	<u>Percent</u> e = d / a	<u>Surplus</u> f = b - d	<u>Percent</u> g = f / a
GTE - North	Illinois	1,768,944	888,668	50.2%	775,837	43.9%	112,831	6.4%
	Indiana	1,970,170	959,335	48.7%	778,817	39.5%	180,518	9.2%
	Michigan	1,533,529	728,459	47.5%	648,221	42.3%	80,238	5.2%
	Ohio	1,643,754	840,673	51.1%	692,332	42.1%	148,341	9.0%
	Pennsylvania	1,198,085	603,539	50.4%	483,943	40.4%	119,597	10.0%
	Wisconsin	<u>1,106,962</u>	<u>584,977</u>	<u>52.8%</u>	<u>474,432</u>	<u>42.9%</u>	<u>110,546</u>	<u>10.0%</u>
	Total	9,221,444	4,605,652	49.9%	3,853,582	41.8%	752,070	8.2%
GTE - Florida	Florida	<u>4,229,287</u>	<u>1,852,788</u>	<u>43.8%</u>	<u>1,708,393</u>	<u>40.4%</u>	<u>144,395</u>	<u>3.4%</u>
	Total	4,229,287	1,852,788	43.8%	1,708,393	40.4%	144,395	3.4%
GTE - South	Alabama	618,501	290,522	47.0%	275,003	44.5%	15,519	2.5%
	Kentucky	1,263,220	605,261	47.9%	527,143	41.7%	78,118	6.2%
	North Carolina	852,033	389,895	45.8%	374,781	44.0%	15,114	1.8%
	South Carolina	<u>428,784</u>	<u>214,742</u>	<u>50.1%</u>	<u>200,034</u>	<u>46.7%</u>	<u>14,709</u>	<u>3.4%</u>
	Total	3,162,538	1,500,421	47.4%	1,376,961	43.5%	123,460	3.9%
GTE - Midwest	Iowa	600,445	271,416	45.2%	228,227	38.0%	43,189	7.2%
	Missouri	1,177,808	477,359	40.5%	435,398	37.0%	41,961	3.6%
	Nebraska	<u>117,085</u>	<u>54,125</u>	<u>46.2%</u>	<u>45,468</u>	<u>38.8%</u>	<u>8,658</u>	<u>7.4%</u>
	Total	1,895,338	802,900	42.4%	709,092	37.4%	93,808	4.9%
GTE - Southwest	Arkansas	244,244	107,614	44.1%	107,662	44.1%	-49	0.0%
	New Mexico	217,553	129,571	59.6%	113,099	52.0%	16,472	7.6%
	Oklahoma	253,807	122,655	48.3%	112,625	44.4%	10,030	4.0%
	Texas	<u>4,528,176</u>	<u>2,074,274</u>	<u>45.8%</u>	<u>1,999,466</u>	<u>44.2%</u>	<u>74,809</u>	<u>1.7%</u>
	Total	5,243,780	2,434,114	46.4%	2,332,852	44.5%	101,262	1.9%

Summary of Reserves On FCC Basis

(Dollars in Thousands)

<u>Company</u>	<u>State</u>	<u>1/1/98 Investment</u> a	<u>Book Reserve</u> b	<u>Percent</u> c = b / a	<u>Theoretical Reserve</u> d	<u>Percent</u> e = d / a	<u>Surplus</u> f = b - d	<u>Percent</u> g = f / a
GTE - Northwest	Idaho	358,034	150,310	42.0%	119,345	33.3%	30,965	8.6%
	Oregon	914,345	386,302	42.2%	312,720	34.2%	73,583	8.0%
	Washington	<u>1,990,687</u>	<u>829,021</u>	<u>41.6%</u>	<u>679,920</u>	<u>34.2%</u>	<u>149,101</u>	<u>7.5%</u>
	Total	3,263,065	1,365,633	41.9%	1,111,985	34.1%	253,648	7.8%
GTE - Hawaii	Hawaii	<u>1,781,742</u>	<u>738,288</u>	<u>41.4%</u>	<u>689,512</u>	<u>38.7%</u>	<u>48,775</u>	<u>2.7%</u>
	Total	1,781,742	738,288	41.4%	689,512	38.7%	48,775	2.7%
Contel of CA	California	<u>883,532</u>	<u>466,727</u>	<u>52.8%</u>	<u>423,520</u>	<u>47.9%</u>	<u>43,207</u>	<u>4.9%</u>
	Total	883,532	466,727	52.8%	423,520	47.9%	43,207	4.9%
GTE/Contel of VA	Virginia	<u>1,150,322</u>	<u>493,150</u>	<u>42.9%</u>	<u>479,103</u>	<u>41.6%</u>	<u>14,047</u>	<u>1.2%</u>
	Total	1,150,322	493,150	42.9%	479,103	41.6%	14,047	1.2%
GTE	Total	30,831,049	14,259,674	46.3%	12,685,001	41.1%	1,574,673	5.1%
All Large LECs	Total	264,005,621	129,508,588	49.1%	124,971,870	47.3%	4,536,718	1.7%

Source: Carrier submissions pursuant to Section C-1 of Depreciation Study Guide

Attachment 3

Market-to-Book Ratios

<u>ILEC</u>	<u>Book Equity (\$ Mil.)</u> a	<u>Write- Down (\$ Mil.)</u> b	<u>Adjusted Book (\$ Mil.)</u> c = a + b	<u>Shares (Mil.)</u> d	<u>Book Per Share</u> e = c / d	<u>Market Per Share</u> f	<u>M / B Ratio</u> g = f / e
1. Ameritech	\$10,792	\$2,415	\$13,207	1,101	\$11.995	\$55.625	4.64
2. Bell Atlantic	12,604	4,659	17,263	1,553	11.116	56.563	5.09
3. BellSouth	15,899	3,231	19,130	988	19.363	87.813	4.54
4. SBC	11,531	6,254	17,785	1,837	9.682	48.688	5.03
5. U S West	625	3,564	4,189	502	8.345	63.188	7.57
6. GTE	8,208	4,884	13,092	962	13.609	61.813	4.54

Source: 9/30/98 Financial Reports
11/30/98 Market Prices

Attachment 4

ILEC Acquisitions

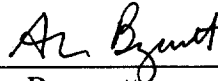
(\$ Billions)

	<u>Buyer</u>	<u>Bought</u>	<u>Price</u> a	<u>Book</u> <u>Equity</u> b	<u>Write-</u> <u>Down</u> c	<u>Adjusted</u> <u>Book</u> d = b + c	<u>Premium</u> e = a - d
1.	BA	Nynex	\$23.5	\$7.6	\$2.4	\$10.0	\$13.5
2.	SBC	Pacific	15.7	2.4	3.2	5.6	10.1
3.	SBC	SNET	4.4	0.5	0.5	1.0	3.4
4.	SBC	Ameritech	61.3	8.3	2.4	10.7	50.6
5.	BA	GTE	52.9	7.6	4.9	12.5	40.4

Note: L4 and L5 acquisitions pending

STATEMENT OF VERIFICATION

I have read the foregoing, and to the best of my knowledge, information, and belief there is good ground to support it, and that it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on December 8, 1998.



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CERTIFICATE OF SERVICE

I, Vivian I. Lee, do hereby certify that copies of the foregoing Reply Comments were sent via first class mail, postage paid, to the following on this 8th day of December, 1998.

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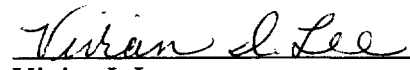
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